CHAPTER 1. ADMINISTRATION

1-1. INTRODUCTION. A cooperative insured under Section 213 may obtain an insured supplementary loan to finance improvements or repairs on the property covered by the mortgage or to acquire community facilities. The supplementary loan procedure is limited to management type cooperatives, the maturity cannot exceed the remaining term of the mortgage (except as indicated below), and the loan amount when added to the balance due on the mortgage cannot exceed the original principal amount of the mortgage, unless improvements or additional community facilities are involved, in which case see Section 213.7(1)(1) of the Regulations. This legislation differs somewhat from the home improvement loans under Section 220 in that the loan will normally be made in connection with a project already covered by an insured mortgage loan and will thus be simpler insofar as eligibility and loan security questions are concerned and will in some respects resemble an "open end" loan. Properly implemented it will be advantageous to HUD-FHA as well as the occupants by enabling the mortgage security to be repaired and improved when deemed necessary or advisable by HUD-FHA.

a. The 1964 Amendment to Section 213(j)(1) of the National Housing Act extended insurance for supplementary cooperative loans to include a loan made for the purpose of financing cooperative purchases and resales of memberships which involve increases in equity; but, in such resales the cash down payments by the new members must not be less than those made on the original sales of such memberships. To be eligible for a loan to finance the purchase and sale of a cooperative membership, at least three years must have elapsed since the final endorsement of original mortgage and the latest insured supplemental cooperative loan for this purpose.

b. The Housing and Urban Development Act of 1968 further amended Section 213(j) by authorizing HUD-FHA insurance of supplementary loans to housing cooperatives which purchased housing from the Federal Government under uninsured mortgages which represented a part of the purchase price of the housing. Such loans are subject to the usual Section 213(j) supplementary loan limitations, except that the maximum maturity may be up to 10 years beyond the remaining term of the uninsured mortgage where the loan is for major rehabilitation or modernization and the mortgage is more than 20 years old.

1-2. APPLICATION FOR MORTGAGE INSURANCE. In applying for a Supplementary Cooperative Loan, Application for Mortgage Insurance, FHA Form 3201-A is used.

1-3. ELIGIBILITY.

a. Eligible Loans. It is to be noted that loans of this nature may only be made to management type cooperatives whose property is covered by project loans previously insured under Section 213. In the case of Supplementary Cooperative Loans, the loan amount when added to the balance due on the mortgage at the date the commitment is issued should not exceed the original principal amount of the mortgage.

b. Eligible Projects. The original legislation limited eligible borrowers to Management Type Cooperatives insured under Section 207 prior to the Housing Act of 1950. A 1968 amendment to Section 213(j) of the National Housing Act now authorizes the Secretary to insure supplementary loans for cooperative projects purchased from the Federal Government which are covered by an uninsured mortgage. Under this provision, in cases where major rehabilitation is involved, and the original uninsured mortgage was executed more than 20 years prior to the insurance commitment, the refinancing mortgage may have a maturity date up to 10 years in excess of the original uninsured mortgage.

(1) Unlike the improvement program under Section 220(h) of the Act, the property need not be located in an Urban Renewal area to be eligible.

(2) In determining whether a proposal is feasible, the Field Office should consider, in addition to the desirability of the improvements, the increase which will be required in the monthly carrying charges of the cooperative members. The Field Office must be satisfied that the project will still be attractive from a market standpoint after taking into account the increased carrying charges which will be required.

1-4. NATURE OF IMPROVEMENTS. To be eligible, the loan must be for the purpose of financing improvements or repairs to the property covered by the insured mortgage or for the construction or acquisition of appropriate community facilities whether or not located on the property included in the previously insured project mortgage. Generally such loans will be for basic improvements to the real estate to make properties more livable and adequate. Basic improvements include new work, structural alterations and reconstruction, planning, and changes for improved functions and modernization. Basic improvements also include changes for aesthetic appeal and elimination of obsolescence, reconditioning and replacement in plumbing, heating, air conditioning and electric work as well as new roofing and sidewall work and trim, flooring and tiling, and major landscape work and site improvement. When such basic improvements are to be effected, related fixtures such as cooking ranges and refrigerators and appurtenances as well as general painting and decorating are also eligible. Circumstances will vary from project to project and therefore it is not possible to specify all items which would or would not be eligible. In situations where the proposed improvement does not come within the foregoing definition but the Field Office Director is of the opinion that a supplementary loan would be sound and desirable, he should forward his recommendation on the subject to the Director of the Office of Unsubsidized Insured Housing Programs.

1-5. PREVAILING WAGE REQUIREMENTS. Prevailing wage requirements are applicable to the work to be performed and the commitments require the submission of the appropriate forms on this subject. Obviously, however, when the loan is for the purpose of purchasing an already completed community facility, there will be no prevailing wage requirements to be met.

1-6. COST CERTIFICATION. It has been administratively determined that the loan may not exceed the actual cost of the improvements, repairs or community facilities, as approved by HUD-FHA. Thus, the loan will be reduced prior to final endorsement by the amount of any excess over such actual cost. While the Section 227 cost certification procedures are not statutorily applicable, outstanding cost certification forms will with appropriate adaptations be followed.

1-7. FINANCING. The lender may make a charge of an amount not to exceed one and one-half percent (1-1/2%) of the original principal amount of the supplementary loan for services rendered in the origination and closing of the loan. Although the regulations state, "Any additional charges shall be subject to prior approval of the Secretary," it has been determined that as a matter of policy no additional charges will be allowed.

1-8. CLOSING REQUIREMENTS. The closing check list applicable is FHA Form No. 3257-C.

1-9. FNMA ELIGIBILITY. The FNMA Seller's Guide indicates that under appropriate circumstances, a supplementary loan under Section 213 is eligible for FNMA purchase.

1-10. LOAN SECURITY. Security on these loans will normally be a recorded lien against the property on a form prescribed by HUD-FHA and consistent with the laws of the State in which the property is located. Any proposal not meeting this requirement must be forwarded to the Office of the Director of Unsubsidized Insured Housing Programs accompanied by the recommendation of the Field Office Director with identification of the reasons why a recorded lien is not possible under the circumstances. Evidence that title to the property is vested in the borrower as of the date of endorsement will be required. The Regional Attorney should satisfy himself that the transaction does not adversely affect the title insurance coverage applicable to the previously insured Section 213 project loan.

1-11. CONSENT BY HOLDERS OF PRIOR LIENS. In view of the fact that most outstanding mortgages contain a covenant against the creation of liens and alterations or modifications to the property, it is essential that the borrower obtain the consent of the holders of prior liens. A signed copy of the letter(s) from the paramount lien holder(s) stating that there are no objections to the proposed improvements or the loan transaction should accompany the application for the insured loan. This clearance may save the borrower unnecessary expense and later difficulties. However, if the outstanding mortgage contains the provisions for supplementary loans, such mortgagee consent will not be required.

1-12. ARCHITECTURAL EXHIBITS. The use of the words "Drawings" and "Specifications" in the commitment and other administrative forms does not mean that drawings and specifications prepared by a qualified architect are an absolute requirement. Although this may be desirable where the rehabilitation of a project includes major structural changes, plans and specifications

prepared by other than a professional architect may be accepted if they are adequate to the extent that they completely describe the work to be performed and related conditions. In those instances where rehabilitation is limited to relatively minor modifications, such as: moving partitions; cutting openings in existing walls; changes in utilities; installation of new plumbing fixtures; resurfacing of floors; patching of plastered surfaces; rebuilding of stairways; etc., sketches, line drawings, and/or narrative outlines of the work may be considered adequate if they provide ready identification of the work to be performed. "Drawings" and "Specifications" described above as adequate for HUD-FHA processing, will be considered as adequate exhibits to the Mortgagor's Certificate, the Building and Loan Agreement, and the contract documents.

1-13. RELATIONSHIPS OF SUPPLEMENTARY COOPERATIVE LOAN TO WITHDRAWALS FROM REPLACEMENT RESERVE. The Replacement Reserve is intended to be available to defray, at least in part, the timely replacement of worn and obsolete structural components and mechanical equipment included in the breakdown of the Reserve. In arriving at the replacement schedule HUD-FHA makes an estimate of useful life for each component on the basis of experience tables and technical information available to it.

a. It is obviously impossible to forecast the life of every item with absolute accuracy. Conditions of usage, changes in the character of services, evolutions of custom, etc., are unpredictable factors which cause results to vary. Estimates of this character are further affected by changing economic conditions which are reflected in material and labor costs.

b. The Reserve is regarded as an entire fund and HUD-FHA is guided by the test of reasonableness in arriving at a judgement to measure releases of monies from the reserve so as to be acting in the best interest of the cooperative and the Commissioner as insurer of the mortgage. By formal agreement between HUD-FHA and the mortgagor the breakdown of Reserve for Replacements can be revised whenever operating experience indicates the need for revision.

c. Recognizing that from time to time large scale replacements may become necessary or desirable as a result of unforeseen

circumstances (for example, replacement of plumbing because increased use has rendered original specifications inadequate or water chemicals have caused unusually rapid deterioration; rewiring because original wiring specified has become obsolete by virtue of increased appliance usage including air conditioning; and so forth). HUD-FHA has been reasonably liberal in permitting the cooperative to borrow monies from its accrued reserve on the basis of a reasonable program of repayment.

d. In many cases the objectives of a supplementary loan may be achieved by permitting a cooperative to, in effect, borrow its own money by obtaining release of a portion of its reserves on a repayment basis.

(1) Since in some cases this represents the most economical method of making needed replacements or capital improvements without endangering the economic stability of the cooperative serious consideration will be given to such requests.

(2) At the same time, however, the maintenance of an adequate replacement reserve must be recognized as extremely important to both the cooperative and the Commissioner as insurer of the loan.

(3) All of these factors must be weighed by the Field Office and prior to approving any unusual withdrawals from the replacement reserve.

1-14. APPROVAL OF COOPERATIVE MEMBERSHIP. The application should be accompanied by evidence that the members have voted in favor of the improvement proposal in sufficient number to comply with legal requirements and indeed the proposal should be of such desirability and soundness as to have obtained the support of an overwhelming majority of the membership.

1-15. SUPPLEMENTARY LOANS TO FINANCE RESALES OF MEMBERSHIPS. The Housing Act of 1964 provides for supplementary loans for financing cooperative purchases and resales of memberships which involve increases in equity. A cooperative is eligible for such a supplementary loan where the Field Office is satisfied that the following requirements (in addition to the usual conditions applicable to supplementary loans) are complied with:

(1-15) a. The cooperative has developed a sound plan and has retained competent bonded personnel to administer the revolving fund;

b. The cooperative will require new members to make down payments in amounts not less than the amounts made on the original sales of such memberships;

c. The cooperative will invest any unused portion of such loan in obligations issued, or guaranteed as to principal by the United States Government and will make withdrawals therefrom only for the purpose of financing purchases and resales of memberships;

d. The cooperative will require the borrowing member to repay his loan in monthly installments to principal large enough to enable the cooperative to meet its payments on its supplemental loan. The interest rate charged the borrowing member should be a rate in excess of the cooperative's rate of interest on the supplementary loan so that repayment of the loan is on a sound basis, but, the borrower's rate shall not exceed the legal interest rate in the state;

e. The cooperative will add installment repayments to the invested funds referred to in (c) hereof, so as to create a revolving fund;

f. In processing an application for membership the cooperative will take into account the applicant's financial ability to repay the loan while at the same time making his usual monthly carrying charge payments;

g. A supplementary loan of this nature will be approved for individual projects at intervals not oftener than once in every three years;

h. No member remaining in occupancy is to be permitted to recoup his equity, as it is intended that the funds will be used only to finance the repurchases and resales of the units;

i. Commitment Form 3209-B is to be used. Among other conditions, this will require a Regulatory Agreement to be executed by the cooperative obligating it to comply with the conditions of the loan.

1-16. COMMITMENT FORMS.

a. Where insurance of advances is desired, the correct form is Commitment for Insurance of Advances of Supplementary Cooperative Loan, Section 213, FHA Form 3206-A. Where the loan is to be insured only after completion of the improvements, the appropriate form is Commitment to Insure Supplementary Loan upon Completion, Section 213, FHA Form 3209-A. (The commitment form to be used in connection with supplementary loans for financing repurchases and resales of memberships is specified in the preceding subsection.)

b. Where the requested loan amount is comparatively small, the latter form of commitment may serve the purpose, but there is no arbitrary dollar limitation applicable in this regard. This is to be distinguished from the $40,000 limitation which has been established in the improvement loans insured under Section 220(h) to distinguish home and project transactions. Since a cooperative is a non-profit entity and normally does not have unobligated funds or credit at its disposal, it will probably find it necessary in most instances to pursue the insurance of advances route and therefore no arbitrary dollar limitation has been established.

1-17. MORTGAGE (OR DEED OF TRUST) COVERING SUPPLEMENTARY COOPERATIVE LOANS. Until such time as standardized forms have been issued, it will be necessary to obtain administrative and legal clearance from Washington as to the form to be employed in a particular jurisdiction.